RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 10, 1991 **LETTER 1073**

June 28 DJIA 2906.75; PTI 3292; A-D Ratio -12.23
July 5 DJIA 2932.46; PTI 3303; A-D Ratio -12.06
Dow Yield: 3.14%; Dow P/E: 19.5; DowPow: -74
Dow 200-day MA: 2741; Dow 30-day MA: 2960
Dow Book Value: 1276; PTI 89-day MA: 3260
Percentage of Undervalued Blue-chips: 13%

THE PICTURE: In a nutshell: My PTI is still bullish, the D-J Averages remain in a trading range but have not broken down. Stocks are still extremely overvalued. Money supply growth is still negative.

Near-term -- Technicals: From a trading standpoint, the most important consideration now is that this market is becoming oversold.

Recently, the Value Line and NASDAQ Composites both broke below their May lows, giving these indices a "topped out" look. However, the Dow, the S&P 500 and the NYSE Index refused to confirm, and all have held in trading ranges, ranges that have been in force ever since last February. The Utility Average, thanks to Columbia Gas, has broken down (Columbia gas is stuck with $6 gas contracts when the same gas can be bought today for around $1.25).

My **Primary Trend Index (PTI)** has been rising ever since last February (see page 2 chart), meaning that despite the trading range in the averages, the market was showing continued technical strength. That was up to June 4, the day when the PTI registered its high of 3313. In the last two Letters I drew attention to the rising trendline that defined the path of the PTI since its low recorded on January 31.

Following the June 4 peak, the PTI turned down. Two weeks ago the PTI broke below its rising trendline, and I discussed that in the last Letter. Since then the PTI has waffled, moving generally sideways. At this point, it is too early to gauge the significance of the violation of the trendline.

As subscribers know, I grade the PTI bullish or bearish according to its position above or below its moving average. This is a strictly mechanical designation, but it has worked very well in the past. Despite that fact that the PTI has violated its rising trendline, it is still holding ABOVE its moving average. Therefore, for those who trade or invest on the basis of the PTI, you should know that I continue to grade the PTI bullish.

On page 2 I show the chart of another valuable study that I follow (although I don't often write about it). This is the **"Summation Index" (SI),** an index based on the juxtaposition of two exponential moving averages of breadth (it's based on a breadth study invented by Sherman McClellan). The best way to describe the SI is as follows: when the SI is rising, money is moving into the market. When the SI is falling, money is leaving the market.

The important point to realize here is that the Summation Index topped out last March, and it has been declining ever since. It has been going down for almost four months. Historically, this is a long time for this Index to decline. The longer and further the SI declines, the nearer the market is to a sold-out condition. So based on the action of the SI, it is clear that this market is now approaching an oversold state.

To me, the most impressive thing about the current situation is this -- despite the four-month decline in the SI, the NYSE Composite (shown on the chart) never broke down (i.e., never broke below its May low). If four months of internal downside correction can't break the Composite down, it seems to me that the market wants to go higher (but, of course, up in its own good time).

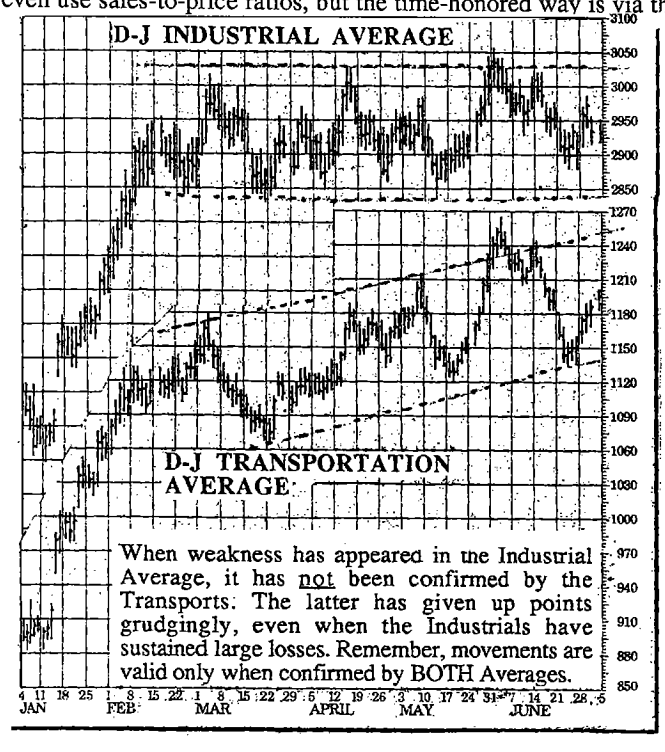
So somewhere ahead (and probably fairly soon) the SI will bottom out, turn up, and finally break above its four-month declining trendline. When that happens, I would guess that we could see a sizeable rally in the market, a rally that could take the Dow to new highs. It could be a rally that would last into August or longer. I base all this on the long decline in the SI, and the probability that the SI is moving into position to reverse to the upside and finally break above its declining trendline.

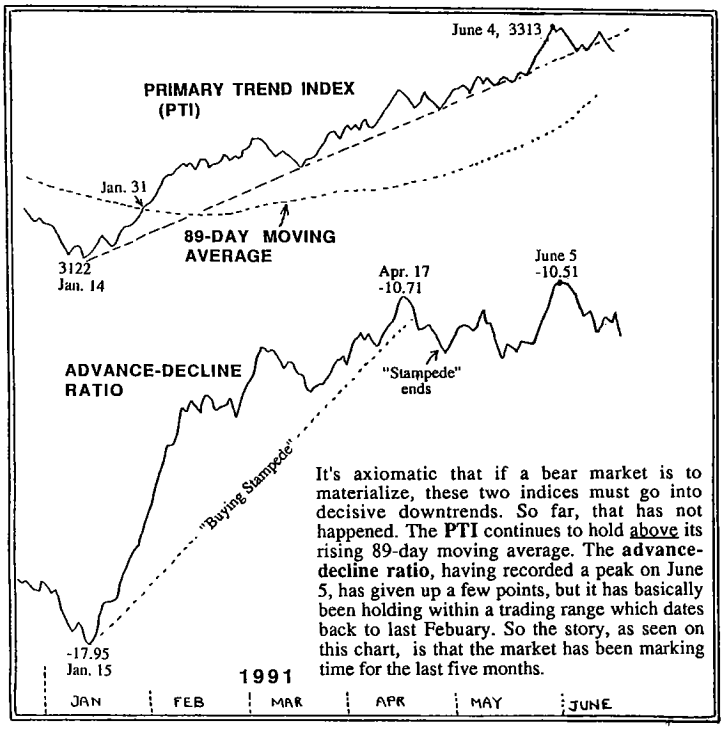
So those are the technicals that I am watching: (1) the still-bullish action of my PTI and (2) the increasingly sold-out appearance of the Summation Index.

Long-term -- Fundamentals: From an intermediate standpoint, the market appears to be oversold or nearly oversold. However, from a long-term standpoint, this market must contend with a major problem. Aside from whether it's overbought or oversold, aside from whether there's too much optimism or too much pessimism, aside from whether there are confirmations or non-confirmations, the overriding problem for this market is also its most basic one -- it's OVER-VALUED.

I've been talking about values for many months, because a consideration of values constitutes the very guts of the Dow Theory. In studying major tops and major bottoms, the most important and the most consistent gauge, bar none, is stock values.

How do we measure overall value in the stock market? Some analysts use price/earnings ratios, some use book value, others even use sales-to-price ratios, but the time-honored way is via the


D-J INDUSTRIAL AVERAGE
D-J TRANSPORTATION AVERAGE
When weakness has appeared in the Industrial Average, it has not been confirmed by the Transports. The latter has given up points grudgingly, even when the Industrials have sustained large losses. Remember, movements are valid only when confirmed by BOTH Averages.
JAN
FEB
MAR
APRIL
MAY
JUNE


June 4, 3313
PRIMARY TREND INDEX
(PTI)
Jan. 31
89-DAY MOVING
AVERAGE
3122
Jan. 14
Apr. 17
-10.71
June 5
-10.51
ADVANCE-DECLINE
RATIO
"Stampede"
ends
"Buying Stampede"
-17.95
Jan. 15
1991
JAN
FEB
MAR
APR
MAY
JUNE
It's axiomatic that if a bear market is to materialize, these two indices must go into decisive downtrends. So far, that has not happened. The PTI continues to hold above its rising 89-day moving average. The advance-decline ratio, having recorded a peak on June 5, has given up a few points, but it has basically been holding within a trading range which dates back to last Febuary. So the story, as seen on this chart, is that the market has been marking time for the last five months.

return on investment (i.e., the dividend yield). And here the yield that is most often watched is the dividend yield on the D-J Industrial Average. This is also the study which provides us with the longest real time data.

Charles Dow noted that when stocks yield only 3.5% or less, they are expensive. He also noted that when stocks yield 6% or more they are attractive and nearing or in the bargain area. History certainly confirms Dow's turn-of-the-century observations. Great market bottoms, in which the the Dow yield rose to 6% or more, were seen in 1932, 1942, 1949, 1974 and 1982. Important tops, during which the Dow yield sank to around 3%, were seen in 1929, 1959, 1961, 1966, 1968, 1973 and 1987.

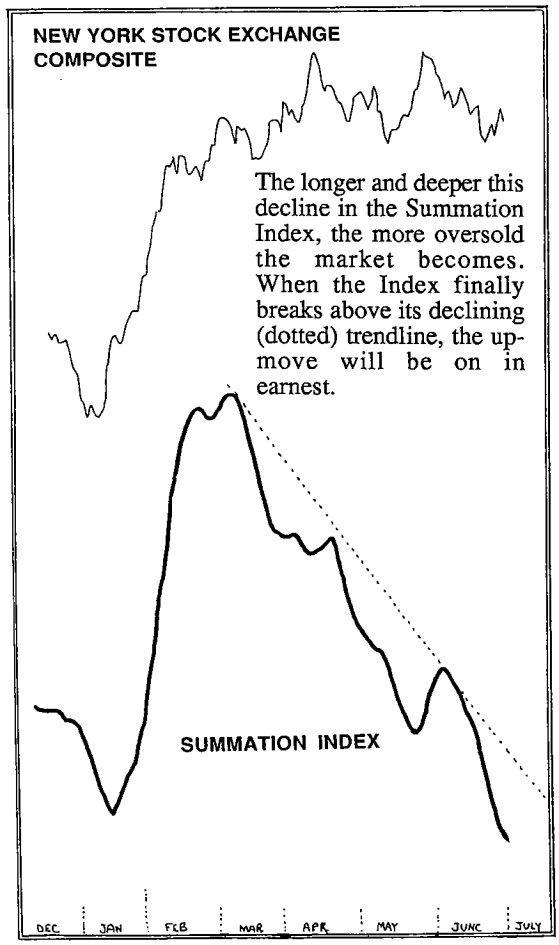
A low-yield record was recorded in mid-1987 (just before the crash) when the yield on the Dow dropped into the 2.5% area. At that time government bonds were yielding 10%. This meant that the bond-to-stock yield ratio was a highly dangerous 4-to-1, and I warned about this at the time.

How does this compare with the situation today? Gerry Weiss (*IQ Trends* here in La Jolla) is "the keeper of the dividends." She tells me that Dow dividends are currently 93.02. Based on this figure, at the recent high (Dow 3035.33 on June 3) the Dow was yielding a minuscule 3.06%. That's a dangerously low figure, a figure that is consistent with a major top. And with T-bonds at an 8.4% yield, the ratio of bond to stock yields is 2.7, nothing like the flagrant 1987 ratio, but still not a healthy ratio.

Since January there have been seven upward stabs by the Dow, each thrust seeking to take the Dow above the 3000 level. On two occasions the Dow was able to push above 3000 and close there. The first time, in mid-April, the Dow held above the 3000 level for a single day before selling off. The second time, in late-May and early-June, the Dow held above 3000 for six consecutive days before dropping below 3000 again.

So the story continues to be the Dow and the market locked in a trading range. But what is the rationale for the Dow stalling out in the 3% to 3.5% yield zone? The rationale is this -- these low yields, historically, have marked the general area where a bull market has discounted the best that could be seen ahead.

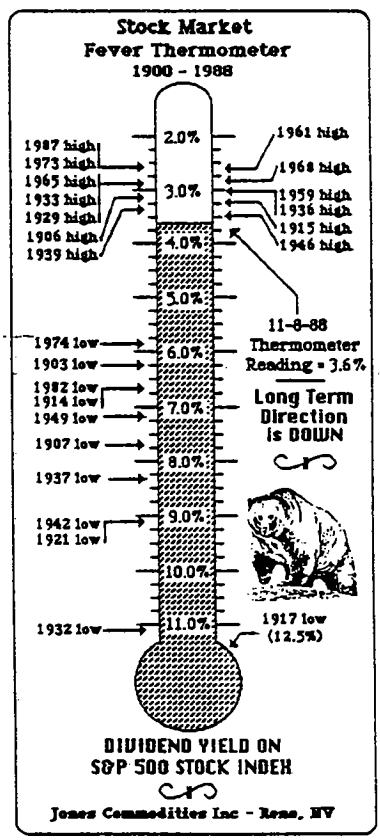
So in reality the yield on the Dow, as well as being a gauge of value, is a measure of crowd sentiment. In fact, famed market

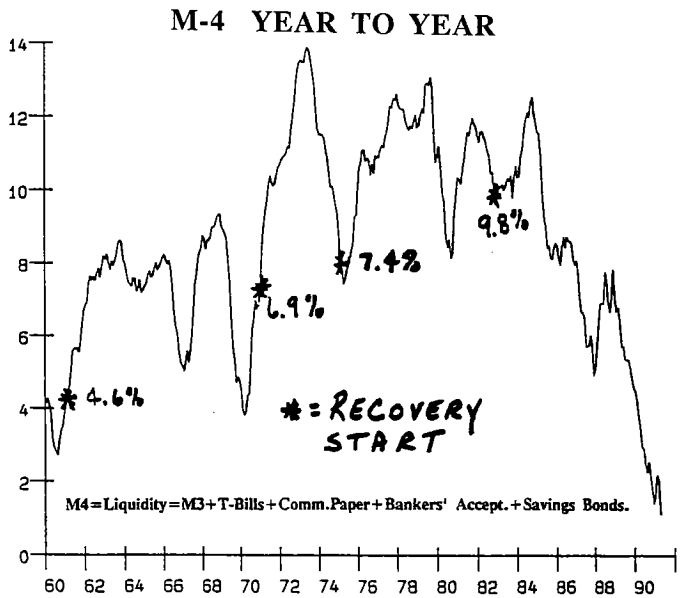

NEW YORK STOCK EXCHANGE
COMPOSITE
The longer and deeper this decline in the Summation Index, the more oversold the market becomes. When the Index finally breaks above its declining (dotted) trendline, the up-move will be on in earnest.
SUMMATION INDEX
DEC
JAN
FEB
MAR
APR
MAY
JUNE
JULY

analyst Edson Gould illustrated this thesis with his "Senti-meter." About five years ago my friends at *Jones Commodities* published a version of Gould's Senti-meter, and I include that device here. This "fever thermometer" shows the dividend yield on the S&P 500 together with all the important tops and bottoms. It's a picture well worth studying. The current yield on the S&P 500, by the way, is 3.19%.

I've talked about values (via yields) and I've talked about price trends (via the PTI and SI). Finally, a bit on economics. From all accounts (at least from the blaring headlines in the newspapers), the recession is over. And the recovery is just around the corner. We'll see.

The page 3 chart from Ed Hyman's vast chart library (*International Strategy and Investments,* 717 Fifth Ave. NYC 10022) tells a vital story. The story is this -- you can't have a real economic recovery unless you have the money to generate the recovery. The chart traces the year-to-year change in liquidity. Liquidity (M-4) is the broadest measure of the money supply, and it includes M-3 + T-bills + commercial paper + bankers' acceptances + savings bonds.





Ed Hyman notes that over the past year M-4 has increased only 1.1%, a record low. He further notes that on average, at the beginning of previous recoveries, M-4 was already growing at a 7% rate. Note that the chart denotes previous periods when recoveries began as well as the actual M-4 growth rate as each recovery began. Question: with almost no current year-to-year growth in M-4, can the current recessionary economy turn around?

International View: The following is from my friend Dave Fuller (*Fuller Money,* 7 Swallow St., London WIR 7HD, UK). "By June 20 eight of the 26 stock markets that I follow most closely had reached new recovery highs for the month: Canada, Denmark, France, Germany, Italy, S. Africa, Sweden and the USA. This is not a bad performance, but there has been a gradual slowing of momentum over the year. In January and February every index rallied. There were 24 new recovery highs in March, slowing to 19 in April, 10 in May, and now eight. Of these eight, only Denmark, Germany and S. Africa scored significant upward breaks . . . A number of indices are not far off their highs for this cycle. However, most are in trading ranges, so downside break points are also close at hand and could be reached quickly. The immediate risk is for a downward reaction."

INVESTMENT POSITION: The bull's in the box. He's still got palsy, because he's well aware of market overvaluation. But he isn't running, because he also knows that this market is becoming increasingly oversold, the PTI remains bullish, and major averages are refusing to break below their May lows.

This is a trader's market. Because the market is overvalued, I feel that rewards on the upside are limited. However, that doesn't mean that the market won't try. For the majority of subscribers who don't usually trade, the safest and probably most intelligent place to be is Treasury paper of one year or less.

I follow about 30 mutual funds carefully, and I note that over the past three or four months almost all of these funds have been declining in relative strength (I compare the fund's action with that of the S&P 500 Composite). I think this is significant. When the pros can't keep up with the market, it tells me that the market is getting difficult and tricky. Interestingly, the gold funds broke out to new relative strength highs over the past two weeks, and if you don't have any gold mutual funds this is the time to get your feet wet.

No-load gold funds I like are Benham (800) 472-3389, Blanchard Precious Metals (800) 922-7771, Financial Strategic Gold Fund (800) 525-8085, and Lexington Gold (800) 526-0056.

ADVICE: Who's entitled to give advice, to tell the other guy what to do? I'm not sure, but I guess it's the person who's gone through it. Also, of course, it's the person with enough ego (chutzpah?) to think that when he has something to say, it's worth listening to.

This month I'll be (gad) 67, and I've gone through quite a lot and somehow survived it all. I've had a lot of great times -- a lot of easy times, and a lot of hard times. I've done a lot of things, and here are some of my credentials for shoveling out advice. I've had two divorces and three marriages. I've lived half my life on the East Coast, half on the West (I like the West better). I survived combat as a bombardier (Twelfth Air Force) in WWII. I've been mugged and roughed up in both NYC and in San Francisco and lived to tell it. I've got five kids, four of them healthy, one autistic. I've ridden motorcycles for 46 years and I'm still at it. I had a mastoid operation (that was way before antibiotics), and I damn near died from it. I had a double hernia operation (super painful), I had a heart attack (1970), and I had a quintuple bypass (five years ago).

I've worked for an ad agency, I've been a union truck loader (when I was 18), I was a textile designer (cottons), I've been a Cactus fancier since I was 15. I grew up during the Great Depression. I saw Babe Ruth hit a homer in Yankee Stadium. I saw Carl Hubble pitch. I saw American air power knock out the Germans in North Africa and Italy (I was there), I saw Hoover ride an election victory parade through NYC ("Hooray for Happy Hoover," we shouted), I was in NY on VE day when people (not me, of course) were running through the streets kissing anyone in sight. I saw the great jazz of the late-'30s and '40s up in Harlem and on 52nd Street, I've had drinks with Billy Holliday, and I've talked with Janis Joplin. I owned a folk music club in San Diego, I hired Steve Martin and Jackson Brown (at the club) when they were unknowns. I've corresponded with Bernard Baruch, I've danced with Lauren Bacall. I went to college in Greenwich Village (NYU) when the Village was really the Village.

I've had my share of adventures, and it was fun and still is. I moved from NYC (in 1961) to the spot in the US I like best -- La Jolla. I spent around 30 years in various therapies, from classical psychoanalysis (four years, four days a week) to encounter groups to Gestalt therapy to well, you name it. I've talked to Nathan Pritikin, I was in the experimental program for Mevacor to lower cholesterol before is was OK'd by the FDA. I've seen bread for 14 cents a loaf and I've seen new Fords (1938) selling for $450. I've gone to movies when admission was 15 cents. I saw Tommy Dorsey and Glenn Miller and Frank Sinatra at the Paramount on B'way at 43rd (75 cents before noon with a feature movie as well). I remember good sandwiches at the Automat for 25 cents. I remember a nickel cup of coffee and nickel subway ride. I remember when it was unheard of to talk back to a cop. I worked for Postal Telegraph (later merged into Western Union) for $1 dollar a day, and sometimes less (that was back in 1936).

OK, enough of all that. You want to live long and well. You might consider what Carl Jung, the great psychiatrist (he was a friend of Freud's but later broke with Freud) said. He said, "Your only duty on this earth is to find yourself and live accordingly." Believe it, Jung knew from whence he spoke. Freud had his own life formula. He said, "Love and work, that's all there is." Funny thing is -- if you love your work, it isn't really work.

Freud also said, "Thinking is rehearsing." In other words, thinking is fine, but it is merely rehearsing. In the end YOU'VE GOT TO ACT. No amount of thinking is going to get it done, no amount of thinking is going to change your life. Thinking can lay the foundation, but to change, to move on, to grow, brother (and sister), you've got to do the hard part, the risky part, and that is -- TO ACT.

About health. There's a doc named Ornish who wrote a book (it's a best seller today) about clearing your arteries and getting healthy. Ornish says you've got to do three things: (1) You've got to exercise, (2) You've got to eat right, and (3) You've got to meditate. I believe him.

It's also a big help if you can become fascinated with something, I don't care if it's travel, baseball, running, movies, gardening, dogs, a charity. Me, aside from growing Cacti and riding motorcycles, I'm fascinated with markets (you must have guessed that one). And I'm fascinated with the news. I read newspapers and magazines by the carload. The paper recyclers love me.

I also recommend a healthy skepticism. You can be optimistic about life and still retain a healthy skepticism. For instance, I assume a healthy skepticism about everything that comes out of Washington. I know these guys are politicians and keeping their jobs is the most important thing in the world to them. So I am skeptical about almost everything they say, even though I know most of them are good guys and they are doing their best.

Examine people's motives and intentions. Or as a great psychiatrist put it, "When someone talks, I listen to the words, but it's always more informative to listen to the music."

NEW WORLD ORDER: President Bush keeps talking about the "New World Order." I can't figure out exactly what he's talking about. If the Persian Gulf mess was a preview of the New World Order, I'll take the old one, although I was never very enthusiastic about that one either.

I do note this, however. In fiscal year 1990 the US will spend $290 billion on the military. With the Soviets in decline (falling apart would be a better word for it), who the hell are we afraid of -- to the tune of $290 billion? Then there's another $30 billion plus that we're spending on the CIA and $12.4 billion on NASA. Now when you add it up that's a hell of a lot of money. My guess is that the military and NASA are pulling their hair out, looking for a major new enemy.

On top of all that and with Mr. Bush's encouragement, we're shipping tens of billions of dollars worth of arms overseas, mostly to the Mideast. Hopefully, the majority of it will go to friendly nations, but experience tells us that today's good buddy can well be tomorrow's fire-breathing devil. So I look at it this way -- when Eisenhower warned us about the military-industrial complex, he knew exactly what he was talking about.

My own opinion is that the US is barking up the wrong tree. Evidently, Bush is toying with the idea of making the US policeman to the world. I think we should forget it -- we're not very good at it anyway. We're OK on the fighting part of it, but we're lousy on anything that comes after the fighting.

Look at it this way: Noriega is in a US prison, but the Panamanian narcotics trade is as big or bigger than ever. And it looks as if Noriega is going to get off anyway. Saddam is still in power, and he's thumbing his nose at us (or rather waving his pistol at us). And I don't know what's happening in Granada.

The recent US military adventures into foreign lands have proved to be nothing but disasters, as far as I can see. So we ought to announce (officially) that Bush is not a wimp, and then draw a halt to most foreign military adventures, starting now.

The truth is that we've got enough troubles right here at home to keep us busy for years. For instance, in fiscal 1989 the interest on the US federal debt was $240.8 billion. In fiscal 1990 the interest on the debt rose to $264.8 billion. Pretty soon we're going to be spending a billion dollars a day just in interest on the Federal debt. How are we going to finance that kind of compounding horror? And by the way, is that why gold is reviving?

The rising burden of the debt will either force this nation to its knees as the dollar becomes increasingly unacceptable to our creditors -- or we'll attempt to inflate out way out of the debt pit, creating more and more dollars to offset the deficits. Already, Treasury auctions are setting records, and we can expect additional records out as far as the eye can see.

NOTES & QUOTES: We're seeing a big deflation in commodities, but in a lot of the areas that affect the average person, inflation is far from dead. For instance, *Runzheimer Reports on Travel Management* states that overall business travel will cost 5.9% more this year. Air fares will rise 8.1% because of higher labor costs, rising debt payments and new taxes levied by local airports. Car rentals will rise 6% because auto companies will not give as generous terms to rental outfits and airport fees rise along with insurance costs. There will be a 3% rise in lodgings because of higher taxes. Meals will cost 3% more due to slight inflationary pressures. Yeah, happy traveling.

* *

According to the *Retirement Letter,* the real inflation rate in the US is 14%. I can't argue. Nothing I buy or use seems to be getting any cheaper. Certainly, taxes aren't coming down. California has just hit us with all kinds of tax boosts this year. Frankly, if my kids didn't live here I'd seriously consider moving to Nevada or Florida or maybe Texas. A lot of Californians are doing more than thinking, they're calling the moving companies (many heading for Oregon, Nevada or Washington, and I don't mean D.C.).

* *

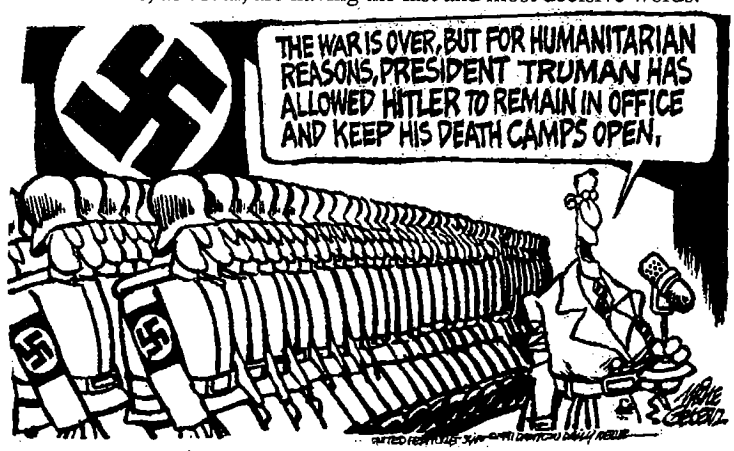
I've been talking a lot about money supply. Here's what Marty Zweig says: "Since 1960 the stock market has remained largely on the defense whenever the growth of the money supply has remained below real GNP growth. This is the case today. The actual real year-to-year M-3 growth rate has been negative for almost two years, with unfavorable implications for stocks."

* *

Analysts keep complaining about declining spending for research and development among US companies. *Forbes* checked and found the following companies that spend far above their industry average on R & D: KLA Instruments, Rohm & Haas, Proctor & Gamble, Sundstand, Syntex, United Technologies, Dow Chemical, Milliporre.

* *

It is now generally conceded that in the Persian Gulf we won the battle and lost the war. Bush's incredible orders to end the war just short of victory will go down in the history books as an inexplicable and disastrous blunder. The Desert Storm result: a hundred thousand civilian casualties, tens of thousands starving, an Iraqi army running amuck, and Saddam Hussein still in charge. With Saddam now thumbing his nose at the UN inspectors, the talk is of possible new military operations. No wonder Bush is looking drawn and grey. By the way, if I see one more Desert Storm parade, or if I see George Bush pin one more metal on a Persian Gulf hero, I may just jettison my TV set. At any rate, the cartoonists, as usual, are having the last and most decisive words:


THE WAR IS OVER, BUT FOR HUMANITARIAN REASONS, PRESIDENT TRUMAN HAS ALLOWED HITLER TO REMAIN IN OFFICE AND KEEP HIS DEATH CAMPS OPEN.

* *

When the markets are moving, companies line up to issue new stock. The June 26 *Investor's Daily* lists no less than 66 companies (that's a LOT) on the list to issue new shares -- everything from Time-Warner's 34,450,000 shares to National Pizza Co.'s 500,000 shares . . . Here's an interesting insight. My wife, Faye, is a corporate lawyer, and she's been working on IPOs. She says that the printer they use (he prints IPO

prospectuses) is so busy that he's running the print plant 24 hours a day. The fact is that new stock issues have been coming out at the rate of over $2 billion a week.

* *

Mayors: San Diego's former mayor, Pete (nobody ever calls him Peter) Wilson, is now governor of California, and the talk is that Pete is presidential material. New York's former mayor, Ed Koch, may be out of office, but he's jawing more than ever. Koch writes a weekly column for the *NY Post*, he tapes a daily radio column, and is on local Fox TV twice a week as a commentator. He does movie reviews for the *WSJ* and he's a national spokesman for Ultra Slim-Fast. With all his new enterprises, Koch makes a million bucks a year now, a lot more than he did as NY's mayor (and he doesn't have to take the flack). Koch's favorite pastime -- bugging and criticizing NYC's current mayor, Dave Dinkins. Dinkin's job -- trying to keep America's biggest city from going bankrupt.

* *

The Soviet's Viktor Alksnis is known as the "Dark Colonel" (he's a three-star colonel in the Air Force). Alksnis is very outspoken, and he speaks for a large section of the Parliament, the military and for the very powerful defense industry. Alksnis warns that the way things are going, the Soviets could dissolve into civil war which "could easily escalate into WWIII." Because Alksnis speaks for such a broad and powerful element in the Soviets, it is thought that fear of the Dark Colonel is what brought Yeltsin and Gorbachev together. Alksnis states that the Soviets should first bring in capitalism, and later bring in democracy. He claims that to bring in democracy first and then the free markets will not work. Alksnis believes that the way the Soviets are currently going with Gorbachev and Yeltsin is the way to disaster.

* *

Women are stronger than men. That's the thesis of an amazing article in the current issue of *"In Health."* The proof: Of the top ten causes of death in people, every one kills more men than women. Women are superior to men in distinguishing colors, they have a sharper sense of both taste and smell. Women have more long-term stamina than men. In a 24-hour run, women can run farther than men (by four miles). Men out-stutter women four to one; men go color blind 16 to one. Men are murdered three times as often as women; men commit suicide at a rate two or three times higher than women. Men have twice as many fatal driving accidents (per mile) as women. Over the age of 20, there are 20% more men smokers than females, but 80% more men die of lung cancer. Grooms are on average only five years older than their brides. But get this -- eighty percent of the population over 65 are women who are living alone. 11 out of 12 women outlive their husbands. Conclusion: men die too young, and women end up sick and alone in their old age. So take your choice -- well, unfortunately, we can't do that.

* *

Are they worth it? Congress itself will cost $1.2 billion this fiscal year, more than double the 1980 cost and seven times more than the 1970 cost. The House of Representatives will cost $698 million or $1.6 million per representative and the Senate will cost $456 million or $4.6 million per Senator. How about the legislative agencies? Well, here's a sample: the General Accounting Office and the Congressional Budget Office will cost $1.3 billion, which is a 14.5% rise over last year.

* *

The US tax system is a disaster costing Americans billions of dollars and employing tens of thousands of accountants, planners, tax lawyers, auditors and IRS people. The whole thing could be eliminated via a simple system -- a national 10% sales tax and a 15% value added tax (every European nation has a VAT tax). Do this and you could eliminate all individual and corporate taxes, and the Treasury would be way ahead. Why doesn't this happen? Answer: political pressure, and the complaint that it wouldn't be fair to the poor. Which of course, is total nonsense. Is inflation fair to the poor? When I was a kid I paid five cents for a NYC subway ride and 25 cents for a ham sandwich. Now I pay $1.15 for a subway ride and $3.50 for a ham sandwich. Is that fair to the poor? In the end, politics dictates everything. The US tax system is a bureaucratic racket employing hundreds of thousands of people, and they take care of their own. So, anyone out there care to run on a national ticket -- a 10% national sales tax and a 15% VAT tax. I can't think of a better or more intelligent ticket.

* *

Got a letter last week from a subscriber, a free-lance writer who just left NYC. He writes, "As a free lancer in NYC I paid 15.3% Social Security, 28% federal income tax, 7.9% state income tax, 3.3% NYC income tax and 4% NYC unincorporated business tax. Sure I had a few deductions, but the final rate came close to 50%. I think my leftist friends have outsmarted me." He's moving.

* *

Why is NYC going broke? Here's one reason: the city employs 353,000 people -- one out of every 21 residents. And 93% of them are union members. That's almost as bad as the US Post Office (which staves off bankruptcy by raising the price of stamps every year or so).

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Did you ever wonder why the nation puts up with all the above? Easy, the rich make money on inflation, so they vote their own interests (and of course, the rich love fat interest rates). The poor get government subsidies and pay-offs so they vote for which ever incumbents give them the most freebies. The disappearing middle class is now so punch-drunk it doesn't know which way to vote -- so they usually just vote for the incumbents in their own party, and these incumbents tend to be inflationists (spenders) anyway. So "on and on it goes, and where it ends nobody knows."

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Well, there must be a way to get a laugh out of this whole governmental disgrace. And there is. By all means read the new book, "Parliament of Whores," by P. J. O'Rourke (Atlantic Monthly Press). This book is not only informative, it's a laugh riot. Example: here's what O'Rourke thinks of the parties: "When you looked at the Republicans you saw the scum off the top of business. When you looked at the Democrats you saw the scum off the top of politics. Personally, I prefer business. A businessman will steal from you directly instead of getting the IRS to do it for him. And when Republicans ruin the environment, destroy the supply of affordable housing, and wreck the industrial infrastructure, at least they make a buck off it. The Democrats just do these things for fun." And on government, says O'Rourke, "A little government and a little luck are necessary in life, but only a fool trusts either of them."

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Commodity trading: Sooner or later, everyone tries it. You subscribe to a new chart service that all but guarantees profits? Go for it. And if it doesn't produce profits, relax. Few, very few escape commodity trading with profits. It's a very tough game. Paul Tudor Jones made $70 million last year in commodities. But for every Jones, there are 500 losers.

Richard Dennis was a major commods trader. His funds made big profits for years. But in '88 his funds lost half their value. So Dennis "chilled out." He left the business for a while. Mmm, in the same year 1988 Dennis personally lost $20 million including $8 million in soy beans in a single day. That would make anyone stop and think. I mean Dennis was a BIG trader.

When I was trading commods I noted the following: you make a little here, you lose a little there, you have a good run. Then you get hit with a "limit down" and you're under water. It's those limit downs that kill you (those plus the bad trades, of course). So my conclusion is that for the average person, trading commodities is both an educational and a losing proposition. The education is that you learn that this is a game for professionals. The losing is God's way of stamping the whole process into your memory.

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FDIC Chairman William Seidman, as Washingtonians go, is pretty honest. On June 27 he came out and said that the FDIC was not doing well. In fact, he said by 1993 the banks' insurance arm would be a whopping $11 billion in the red. This was Seidman's most pessimistic assessment yet. Now ponder this: as of June 21 the total of the assets on the "problem banks" list rose to $430.8 billion (that almost half a trillion bucks). In 1990 US banks wrote off $29 billion in bad loans. But even after that huge hit, their inventory of bad assets rose to $23.5 billion. That means more trouble ahead for the banks. The banks also posted a record for past due loans -- 2.9% of ALL commercial banking assets.

Currently, 13% of ALL construction and real estate loans are classified as "non-current." And you wonder why the banks are reluctant to make real estate loans!

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Right now the strongest major economy in the world is Germany. I had dinner last week with Dr. Kurt Richenbacher of Frankfurt (former manager of the huge Dresdner Bank). The good Doctor told me that Germany is booming, and that even car sales are terrific. He feels that Germany will handle the East German problem very well. When I asked about the US, Dr. Richenbacher shook his head sadly. "The finances here, they're awful." He thinks that American economists "don't see or understand the big picture, the global picture." Richenbacher noted that the Germans are financing East Germany not with new debt but by raising taxes. In other words, they believe in pay-as-you-go, not borrow and spend.

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I spoke before the Benham Funds group in San Francisco last week. Big turnout -- 1,900 people. I asked for a show of hands on those who are holding "any gold items, coins to stocks." Very, very few hand went up -- Interesting . . . SF, great department stores, beautiful sunny days, cold and windy nights. SF must be Mecca for the homeless, they're everywhere, in droves. A lot of tourists come to SF thinking, "California, ah, warm weather." The poor souls run around SF at night (unprepared) in their little cotton dresses and shirts -- and freeze. For restaurants -- I like Postrio. Always a great dinner.

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One place where the US is chronically lacking is in savings. According to economist Ed Hyman's latest figures, the US savings rate is now a tiny 3.62%. Meanwhile the German savings rate is 14.86%, Japan's is 16.87%, France is 12.57%, and even the UK is 10.78% while Canada saves at 12.82%. Japan and Germany in particular, with their high savings rates, are building capital assets. The US is building debt. If these trends continue, in due time the US will be out-produced and its economy will be surpassed by that of other nations.

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Things change. Back in 1958 Sam Arkoff made the movie, "Machine Gun Kelly" for his American International Pictures at a cost of $200,000. Arkoff is now getting ready for a remake of the same movie. The remake (for Columbia Pictures) is budgeted at $22 million. And that's considered small potatoes by today's standards.

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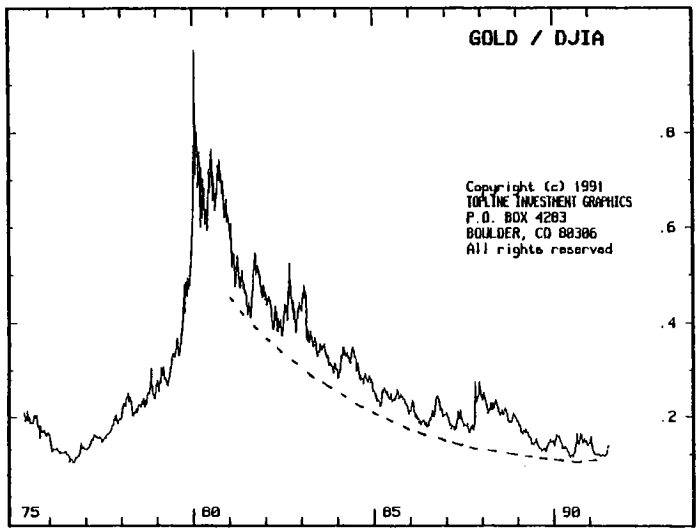
Financial World published a financial run-down on all the professional sports teams. Interesting facts: NY Yankees franchise valued highest at $225 million. Reason: huge media revenues of $69 million, big stadium revenues of $17.7 million, big operating income of $24.5 million. Miami Dolphins are valued second at $205 million, third NY Mets at $200 million, fourth LA Dodgers at $200 million and fifth LA Lakers at $200 million. Biggest gate receipts of any sports team Toronto Blue Jays with whopping $39 million at the gate. NY Mets second with $25.2 million at the gate, third Oakland Athletics with $24.6 million gate. Highest player salary costs -- the SF Forty-Niners at $29.7 million, second SF Giants at $22.5 million, third Boston Red Sox at $22.7 million. Biggest operating income, LA Lakers taking in a fat $30.2 million.

GOLD: Veteran readers know that I have a rule in regard to gold action. The rule is this: You can't have a bull market in gold unless the gold-to-common stock ratio is in a rising trend. In other words, gold has to be acting better than the stock market on a ratio basis if it's a true gold bull market.

Slowly, very slowly, we could be getting there. I asked my computer whiz friend, John Carder, to run off a long-term chart of gold (the metal, not the stocks) divided by the Dow. And here it is, the gold/Dow ratio from 1975 to the present. It's the action from the 1980 peak to the present that interests me.

I have drawn a dotted line that I believe is telling the story. It looks as though the ratio is forming a huge saucer-bottom. Furthermore, over recent weeks many gold stocks have been performing extremely well on a relative strength basis. I follow a number of



gold funds in terms of relative strength and this week the funds broke out to new highs for the year in relative strength.

To me, that's impressive. It's particularly impressive in view of the fact that gold is oversold, it's been kicked out of almost everyone's portfolio, it's hated, and it's "under owned."

Now obviously I can't guarantee that a new gold bull market is about to start, and I can't promise that gold will ultimately "go through the roof," but I do know the following: (1) when a stock group is despised and sold out, (2) and when that same group has been losing relative strength for many years (3) and when that group's relative strength finally turns up -- that's buying time. Why does rising relative strength in a sold-out group spell "buy"? Because when the relative strength finally turns up it means that the group has passed from weak hands to strong hands, and the strong hands are starting to move the group higher again.

I suggest that all my subscribers read the "Round-table" discussion in *Barron's* (July 1 issue). The first person interviewed is Paul Tudor Jones, and his comments on the market, the economy, and gold are most interesting. Jones talks about relative strength in gold, and he offers the opinion that a major move in gold could be on the way. He also agrees with me that gold is sold out, totally out of favor -- even the goldbugs are disgusted with it.

So this is the picture that I think is shaping up with gold. It isn't in "full bloom" yet, and by that I mean that gold is not roaring up in price or relative strength -- yet. But as you can see on this long-term chart, gold relative strength has scraped the bottom and is starting to push up. The stocks have acted better than the metal recently, and the gold funds are at highs for the year.

Gold (metal) is now above its 40-day moving average (the MA now stands at 367). An important breakout would come if the August gold contract were to hit 380.

Silver (Sept. futures) has now moved from a February low of 3.65 to a June contract high of 4.70, a rise of 28.7%. The 40-day moving average of silver now stands at 4.33. A new breakout would come if the Sept. silver contract were to hit 4.75.

LATE NOTES: The US market acts sold out, and my PTI stubbornly holds above its moving average. The biggest danger -- Japan. On July 4 the Nikkei broke below 23 000, and I wouldn't want to see it drop below the psychological 20 000 level.

The dollar has been a tiger. The dollar index (Sept. futures) has rallied from a Feb. low of 92 to last week's 98. If you're a foreigner holding US notes or bonds, that wipes out your interest for the year. Why the dollar strength? One possibility -- Eastern Europe wants dollars not rubles. There's a tremendous demand for dollars from that source. Also, while most European economies appear to be weakening, US economic statistics are improving. Currencies tend to move toward economic strength.

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